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SENSITIVE
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SUBJECT: CAMBODIAN ECONOMIC CRISIS DEEPENS

REFS: A) PHNOM PENH 205
B) PHNOM PENH 97
C) 08 PHNOM PENH 1032

SENSITIVE BUT UNCLASSIFIED

¶1. (SBU) Summary. Cambodia's heady days of double digit economic growth are over. The adverse impacts of the global economic crisis have brought Cambodia's growth to a screeching halt, from 10.2 percent in 2007 to low single digits, if not the World Bank's estimated negative 1 percent in 2009. Nearly all of the pillars of Cambodia's economy - garments, tourism, and construction - have been adversely affected; only the agriculture sector has thus far been unaffected. The economic crisis poses significant challenges to sustaining the country's progress toward its development goals and meeting the needs of the country's most vulnerable affected by the crisis. To date the government's efforts to mitigate the adverse impacts have failed to address the fundamental challenges of sustaining economic growth and a more comprehensive, coordinated response is urgently needed to prevent greater numbers of the population from falling into poverty. End Summary.

Growth Prospects Growing Grimmer

¶2. (SBU) Cambodia's past decade of economic growth was remarkable by any standard. However, it was overly dependent on the garment, tourism, and construction sectors, and now the global economic crisis is exposing the vulnerabilities of this narrowly-based economy. In late 2008, international financial institutions were predicting the economy to grow at between 4.7 and 4.9 percent, which represented a significant slowdown from the average ten percent growth of previous years. However, as the adverse impacts of the global economic crisis hit home, growth forecasts were successively revised downwards. The Asia Development Bank (ADB) currently predicts a growth rate of 2.5% (predicated primarily on an expansion in the agriculture sector); the International Monetary Fund (IMF) predicts growth to slow to -0.5 percent, and the World Bank (WB) forecasts -1 percent.

Deep Impact in the Pillars of the Economy

¶3. (SBU) A significant deceleration in growth is expected in all three of the key sectors of the economy in 2009: garments, tourism, and construction. The garment industry has been the hardest hit of all of the sectors of Cambodia's heavily export-dependent economy (see septel). The sector accounted for an estimated 30 percent of GDP in 2008. In the first two months of the year, however, the volume of garment orders decreased by an estimated average of 30 percent. Compared to the same two months last year, garment exports are down by 40 percent and the value of garment exports declined by 26 percent in January. The Garment Manufacturers Association estimates that 50,000 - 70,000 workers have lost their jobs since Fall 2008, 33,995 in the first three months of the year alone. (Septel reports on the Garment Sector in more detail).

¶4. (SBU) The tourism sector, which grew by nearly 20 percent in

2007, is also showing signs of decline, with growth slowing to 5.5 percent in 2008. During the first quarter of this year, the number of foreign visitors declined by 3.4 percent. While there have been fewer job losses in the tourism sector to date, hotels and restaurants report instituting hiring freezes and job losses are expected to follow.

15. (SBU) Stagnation in the real estate sector has weakened the construction industry. Real estate prices have declined by 30-40 percent in some areas, according to the Bonna Realty Group, Cambodia's prominent real estate company. Large foreign-invested construction projects have stalled or slowed. For example, plans for a seven skyscraper project have been scaled down to three and the project has been delayed until 2010. Construction-related imports declined by 7 percent in the last quarter of 2008. While precise figures are not available, firms report that unemployment among construction workers is on the rise.

16. (SBU) Among the four key pillars of the economy, only agriculture has emerged from the crisis relatively unscathed. The ADB predicts growth in the agriculture sector to exceed the 4.5 percent level achieved in 2008. The sector's growth potential (which accounted for 34.4 percent of GDP in 2008) could help to mitigate some of the adverse impacts of the economic slowdown, such as providing social safety nets for affected workers. However, an expansion in the agriculture sector will not be sufficient to offset the declines in the other key sectors, nor boost Cambodia's sagging GDP. Additionally, the sector remains vulnerable to changing and unpredictable weather conditions and the volatile commodities market.

17. (SBU) While the banking sector was largely sheltered from the

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global financial crisis, the slowing economy is expected to have a secondary impact on the banking industry. The WB and IMF have warned of increased risks of non-performing loans, which are believed to be underreported. The economic slowdown and resulting stagnation in the real estate market will increase the sector's exposure (Ref A). Microfinance institutions report rising delinquency rates, as farmers who borrowed based on the high food prices of early 2008 now find themselves unable to repay their loans due to the steep fall in commodity prices.

Significant Social Consequences

18. (SBU) Slowing growth presents significant social challenges for Cambodia. With unemployment on the rise, it will be increasingly difficult to absorb the estimated 270,000 new job seekers entering the workforce each year. The economic crisis is eroding Cambodia's laudable poverty reduction gains and threatens to put at risk Cambodia's achievement of the Millennium Development Goal 1 percent reduction in the poverty rate in 2009. The country's most vulnerable are still reeling from the high inflation of the first half of 2008. According to a recent WB report, an additional 200,000 people are expected to fall below the poverty line this year, the highest number of "new poor" in the region.

19. (SBU) Rising unemployment and pessimism about future prospects could give rise to a number of social ills, such as drug use, criminal activity, child labor and exploitive labor conditions, and human trafficking. A recent Interagency Conflict Assessment, utilizing the new Interagency Conflict Assessment Framework developed by State and USAID, identified rising unemployment affecting at-risk youth, resulting in illicit behavior, such as drug abuse and gang activity, as a significant threat to Cambodia's political and social stability.

Government's Response

110. (SBU) Despite downplaying the bleak growth forecasts and continuing to officially maintain that economic growth is targeted at 4-6 percent this year, the government appears to be taking the threats to the economy seriously. As recently as April 28, Dr. Hang

Chuon Naron, Secretary General, Supreme National Economic Council, Ministry of Economy and Finance, told a gathering of development partners that 6 percent growth was still within the range of growth forecasts. However, it is not readily apparent that the government has developed a comprehensive strategy for meeting the diverse and deep challenges of the economic crisis head on.

¶11. (SBU) While the government has already taken a number of measures in response to the crisis, these do not appear to have been as part of a coordinated response. In consultation with the private sector, the government adopted specific measures, such as tax relief for the garment industry, expanding foreign vehicle access to promote tourism, and support for agro-business. The government also created a USD7 million dollar fund to provide training and microcredit to laid-off workers and announced the prioritization of pro-poor spending to protect the most vulnerable and provide additional social safety nets. While mitigating measures such as these are badly needed, they do not address the underlying fundamental structural problems which constrain economic growth and threaten to undermine progress towards meeting the country's development goals (Ref C).

Comment

¶12. (SBU) The unique factors that gave rise to Cambodia's decade of rapid economic growth are unsustainable (Ref B). What is really needed are important structural and regulatory reforms to create a more favorable business environment, facilitate trade, and diversify the economic base, enhancing Cambodia's competitiveness in the short and long term. A comprehensive response to the crisis requires close coordination among numerous government ministries and departments, which has proven difficult even in the best of times, and may be particularly more difficult in the face of a declining economy as competition among government entities increases for scarce government resources. It will likely be up to development partners to support the government's efforts by accelerating and coordinating their assistance programs, particularly those in the short term which support vital social safety nets.

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